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# Where to go with the Social Systems?

## **Safeguarding the Future by Restructuring the Financing of Social Security from non-wage Labour Costs to a Consumption-related Social Rate[1]**

Translation by Prof. Hellmut Fischmeister

### **Safeguarding the Social Systems is a matter of economic expediency just as much as of fundamental human rights**

Until the 1980s, the level of social expenses was regarded as a success indicator for advanced societies. With the promotion of a neoliberal concept of globalisation, circumstances - and public (or rather, published) opinion - have changed dramatically.

GATT in 1947 promoted the reduction of customs duties. The main instrument for this was the Most Favoured Nation Clause. In 1995 WTO was founded: Following GATT, the GATS and TRIPS initiatives were started. In the WTO philosophy of globalisation, everything is regarded as a commodity.

Non-wage labour costs for social purposes have become part of the prices in the world market for the enterprises which have to pay them. Consequently, low non-wage labour costs are becoming more and more important among the competition factors in the global economy. In Germany their level is presently about 41%.

Thus the conventional systems of ensuring social security find themselves under increasing financial pressure. This situation, described as the "globalisation trap", involves an export of jobs into countries with low wages, low taxes and negligible social contributions. These states now compete among themselves to become attractive locations for production and business by keeping social costs as low as possible.

At the same time, we have a permanent increase of labour productivity, and the phenomenon of jobless growth. Limits of growth have become visible, while more and more people are trying to sell their labour on the worldwide manpower market. For increasing numbers, classical gainful occupation is giving way to unemployment.

Consequently, social income is becoming more and more important for an increasing number of people, and efforts to reduce these costs are becoming a serious danger for the democratic societies. They offend the basic rights of human beings.

In our days, economy tends to make itself the master of society, instead of its servant, who strives to provide people with goods. Considering the economy as

a whole, the production of income for the population is not a cost factor, but the overall aim. The economy depends on the infrastructure which society has created for it. Moreover, the income of the people is needed as buying power.

How can we escape the dilemma created by these conflicting trends? - We must find a form of financing social security which cannot be endangered by the conditions of a global competition, in other words a competition-neutral form of financing the social systems.[2]

### **Labour - Productivity - Income**

In many developed countries the social insurance systems are financed - at least to a certain degree - through non-wage labour costs which are imposed as contributions to social insurances. In Germany 1997: Pension insurance 20,3%, health insurance 13,6%, unemployment insurance 6,5%, long-term care insurance 1,7, amounting to 42,1%. In Germany one half of this sum is paid by the employees, the other half by the employers. Thus from the gross wage, the wage tax and half of the social insurance contributions (ca. 21%) are withheld. The other half of the insurance contributions must be added to the gross wages as so called employers' contributions.

So the development of the revenues of the social systems is directly tied to labour productivity, the number of employed, their income and their labour time. Public servants, self employed and similar groups do not take part in social solidarity in the present form of the system.

In Germany, productivity per working hour increased from 29,73 DM in 1970 to 61,70 DM in 1995, and this trend is continuing.[3] So it is in other countries. The volume of labour is going down, more people are unemployed and their income must come from the contributions of a decreasing number of employed. That cannot work.

It is necessary to share the fruits of productivity in a reasonable and fair way. Increasing productivity means that we can produce the same quantity of goods - or even more - in less time and with less manpower. There is no reason why certain groups of people should be denied their share in the of the economy. In other words: There is no just reason to refuse to share. The only visible reason could be the disadvantages in global competition which arise from the non-wage labour costs. So the only way to avoid job exports a reduction of social costs - that is the eternal argument. But is it really true?

### **A consumption-related social rate would be a way out of the "globalisation trap"**

The starting situation is quite clear: Globalisation in the form of liberalisation of trade leads to international comparability of products, wages, taxes and social contributions.

Obviously, the method by which the social systems are financed plays a key role. We have to find a way to eliminate the social costs from the price calculation. How can this be achieved? And does it mean that the overall social costs have to be decreased? It does not. The level of social security is not a responsibility of the economy. It has to be determined by the people themselves, by democratic decision. What are we willing to do for our poor, our sick, our elderly, our children etc.? Presently, the threat of competition is making such decisions nearly impossible. Finding a form of financing which does not affect competition would return to the people their right of decision in such matters.

When production is looking for the most favourable business location, social financing becomes a distorting factor. This distortion would disappear if the social system could be financed in a way not affecting labour costs. Prices could then be decreased correspondingly. And there would be no difference for the consumer, if the social contributions were to be set upon these decreased prices, as an expense oriented or consumption oriented social compensation. For brevity, we will call this the *social rate* from here on.

It would work in the same fashion as an added value tax, the only difference being that the social rate is earmarked and is not misappropriated as a general contribution to government outlay. Since the added value tax paid is subtracted from the added value tax owed, the burden is effectively shifted to the final consumer at the end of the chain. In this way, it becomes, in fact, a consumption tax.

An employer can export jobs, but to sell his product, he must go back to the place of consumption. All inland sales are charged with this specific consumption tax, as a result of the democratic consensus about social security in the country concerned. (The level can be adjusted from time to time by Parliament or by direct vote.) All sales abroad are charged with the social consumption rate of the foreign country in which they are sold; the domestic rate can be refunded "at the frontier". So the social rate supports the social security level which the people of that country have decided for themselves.

In this way, social contributions globally would become neutral with respect to competition, but also cost neutral.[\[4\]](#)

From the enterprise's point of view the most important aim - equal chances in competition - is reached. But there will be opposition against this solution from other parts: investors, who want to minimize any kind of social security expenses in the interest of private profit. But property and profit can never have a higher relevance than people and the requirements of social development. Thus this argument can never be accepted.

Another objection may come from the employed. They feel that excise duties are ominous because they hit the "poor" while leaving the "wealthy corporations" untouched. This argument, however, is weak: 1. The corporations devolve all taxes into their prices, so in the end the consumer pays it all, anyway - the only difference being in visibility. 2. If we do not succeed in creating a

new form of social protection, there will be decreasing income and buying power for the very groups, who ask for protection. 3. It is not difficult - assuming that we are able to create the necessary social consensus - to compensate people of low income by suitable income tax exemptions. Another possibility is to scale the consumption taxes for different kinds of goods, as it is being practised in some countries (Germany 7% VAT for food and books, 16% for other goods). Consumption taxes can be shaped to assist social fairness just as income taxes can be shaped to such ends by suitable progression scales.

A more fundamental problem arises from the injustice of any money system which gives money owners special benefits over those who have to spend everything on necessities. In this context we underline that our proposal is only a starting point for the necessary reform of social life.

### **Start with unemployment insurance**

For Germany we have proposed that the reform of social financing should begin with the unemployment insurance. The annual costs for this in 1997 amounted to almost 100 billion DM (1 billion = 1.000 millions. 1 DM = 1.95583 Euro). The contributions of the insured (about 43 billion DM) together with those of the employers (about 47 billion DM) left a deficit of about 10 billion DM to be covered by an allocation of public means. Replacing the unemployment insurance contributions of 6,5%<sup>[5]</sup> by a social rate of 6,5 % on sales would result in an amount of 6,5 x 15 billion = 97.5 billion DM. Thus the expenses can be covered.

Positive job-creating effects are to be expected from such a reform. They arise, firstly, from a relative lowering of German export prices, and in addition, from substituting the use of capital by the employment of human labour.

If the financing instruments are rearranged appropriately, structural effects regarding the sectoral and regional aspects of production need not play a substantial role. The same applies to effects in different income brackets. Besides, a relief for the lower income brackets can be provided within the wage and income tax system. Reduced expenses for unemployment insurance will make means available for this.

However, the positive effects of the reform will be realized only if all groups and individuals concerned work together in its spirit. On the basis of the experiences gained in the process, the model - which helps to revitalize the welfare state's capacity for action - can be expanded to other areas of the social system. In this connection, one may point to Swiss studies on the reform of the pension system based on an analysis of experience with the "second column".

Of course this is only one of the possibilities to implement the reform. Another possibility could be for instance to restructure the financing of a certain percentage of all social insurances every year.

## **Consumption oriented social rate as the key to new ways towards meaningful employment of "surplus" labour**

In view of the continuous growth of productivity, the problem of unemployment cannot be solved primarily by creating new jobs. However, if its gains are put to suitable use, this increase of productivity opens new possibilities to convert - unemployment into work in the non-profit sector. There is no lack of important tasks for such work in our societies! The limits of growth are, in fact, limits to producing ever more without regard to the real needs of men and nature. There are no such limits for new fields of effort within the social services, education, health care, culture, environmental protection etc. etc. Sharing the fruits of increased productivity by creating new forms of social income also means creating job opportunities in these fields, providing an income which allows persons to devote themselves to societal tasks.

The 80:20-society, in which 20% of the people are gainfully employed while 80% are tranquilised by "tittytainment", is not an inescapable fate. We can use the chance offered by the growth of productivity to make new things possible, because we have won the work capacity to do them. Instead of bureaucratically administering unemployment, an "activating" welfare state will enable, above all, the self-determined activity of mature people in the non-commercial, non-profit area, which today is inadequately provisioned.

But all this depends on our safeguarding the financing of social needs. Let us try to regain the capacity to act!

### **Situation of less developed countries**

In many parts of the world there are no social systems, or they do not work, or they can only afford to give alms. So isn't it an act of compensatory justice, when the level of social security is found to dwindle in the rich countries? Granted that there is a necessity within those countries to focus social assistance on those who really need it. But the reason for the lack of social security in the poor countries is not the level of social security in the rich ones. Far from it! The forces which try to bring down the level of social security in the developed countries are at the same time the promoters of a neoliberal exploitation of the less developed countries.

It is the less developed countries which suffer most from the fact that social contributions have become a competition factor. Their low wage level is their only advantage in global competition. By establishing social systems based on non-wage labour costs, they destroy this very advantage. This vicious circle amounts to an insurmountable barrier to the establishment of care systems in these countries. A form of financing social security such as proposed here is the only chance for those countries to build a system of social security.

But there is more: When those countries have to buy products from the rich countries, they are forced to pay part of the social contributions of those coun-

tries, because these costs are included in the prices they have to pay. This money disappears into the rich part of the world. The money gained by a consumption oriented social rate remains in the country and helps - as purchasing power - to strengthen the domestic market. And the situation of the domestic market is the main problem of the developing countries!

## Summary and perspectives

Instead of paying wage and salary related contributions to the social system, we suggest financing, in the same amount, by a consumption-related social rate. This neutral form of financing would permanently relieve the sphere of competitive business from non-wage labour costs<sup>[6]</sup>, improving global competitive power. At the same time it could bring about a lasting change of the job market situation, counteracting the disappearance of solidarity within society, eliminating the pressure on the unemployed, and enabling meaningful and lasting employment of the work capacities set free. This is not only a matter of economic expediency but a fundamental requirement of human rights, since a democratic state must not exclude part of its population from reasonable activity. The introduction of such a social rate is at the same time also an urgent necessity for poorer countries in establishing an adequate social system.

The realisation of such a kind of social rate could be one of the entry points for the development of a society guided by the concept of Nazim Hikmet (1902-1963):

To live! Like a tree alone and free  
Like a forest in brotherhood  
This yearning is ours.

Civil Society should be a motor of this development.

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## Notes

[1] Notes for a Workshop at the World Social Forum 2002, Porto Alegre / Brazil.

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The proposals described here were worked out by Udo Herrmannstorfer (Management consultant and social scientist), Dr. Harald Spehl (Professor of economics at the university of Trier) and C. Strawe. They were presented for the first time at a seminar in Bonn in January 1999. German text >>>

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[2] The suggestions made here are an attempt to respond to this situation. They were presented for the first time at a press conference and a seminar with over 60 participants on 29th/30th January 1999 in Bonn.

[3] See Marion Grote-Westrick, Umfinanzierung der Lohnnebenkosten, Manuscript print 1998.

[4] The conversion of the financing instruments for social costs by an "ecological tax reform", as it is being attempted at present, is to our judgement not a way to finance the social system in a sustainable way. - However, we do not want at this point to go into the problem of a ecological tax system.

[5] Total amount of non wage labour costs 41%.

[6] The terms "non-wage labour costs" are used for the german word "Lohnnebenkosten".